

How does the defeat of DOMA affect my finances?

INTRODUCTION

The recent Supreme Court decision overturning the Defense of Marriage Act (DOMA) is clearly a milestone for the lesbian, gay, bisexual and transgender (LGBT) community. Same-sex married couples may now take advantage of many of the federal benefits previously available only to their opposite-sex counterparts. In addition, the US Treasury Department and IRS affirmed that same-sex couples who marry or already are legally married will retain eligibility for these benefits even if they live in or move to states that do not recognize their union.

The implications for LGBT couples are profound. The following questions may now be answered with greater clarity than was possible immediately after the Supreme Court reached its decision in June 2013.

Q. What federal benefits are available to same-sex married couples that weren't available before?

A. The list is extensive. In fact, same-sex married couples may now be eligible for more than 1,000 federal benefits that may result in lower income and estate taxes, more affordable health care insurance and Social Security spousal and survivor payments.

Q. Can same-sex married couples file a joint tax return?

A. Yes. In the past, same-sex married couples residing in states that recognized their marriage had no choice but to file separate IRS returns, even if they filed their state returns jointly. Thanks to the Supreme Court decision, same-sex married couples may now file a joint federal tax return. Same-sex married couples will now be required to file their returns together as either "married filing jointly" or "married filing separately." Domestic partnerships do not qualify for joint filing. For many same-sex married couples, ►

MARGINAL TAX RATE	MARRIED FILING SEPARATELY	MARRIED FILING JOINTLY
10%	\$0–\$8,925	\$0–\$17,850
15%	\$8,926–\$36,250	\$17,851–\$72,500
25%	\$36,251–\$73,200	\$72,501–\$146,400
28%	\$73,201–\$111,525	\$146,401–\$223,050
33%	\$111,526–\$199,175	\$223,051–\$398,350
35%	\$199,176–\$225,000	\$398,351–\$450,000
39.6%	\$225,001+	\$450,001+

► the question will be whether joint filing is a better strategy than separate filing. That's because joint filing may trigger what is called "the marriage penalty" and push joint filers into a higher tax bracket.

The chart above shows our progressive tax rate structure for separate and joint filers. Notice that the highest 39.6% tax bracket applies only to separate filers with more than \$225,001 and joint filers with more than \$450,001 in income. In some cases, you might be better off filing separately so that one of you can take advantage of the lower tax rate; however, you should discuss with your tax counsel or tax preparer the advantages and disadvantages of each filing method.

Joint filing may be a better strategy for couples in which one spouse earns substantially more than the other. At the same time, however, filing jointly as a married couple enables you to claim deductions and credits unavailable to single filers. These include certain childcare credits, the ability to share capital gains and losses and a higher exclusion of capital gains from the sale of a house (\$500,000 for joint filers vs. up to \$250,000 for single filers).

One more thing—the demise of DOMA enables same-sex married couples to amend their federal tax returns for the past three years. Consult your accountant to determine whether this tactic will lower your tax liability and perhaps generate a refund. Same-sex

married couples are not required to file amended returns for prior years.

Q. What about estate taxes? With no DOMA, should same-sex married couples protect their assets with trusts and other estate planning strategies?

A. That depends on the complexity of your finances, as well as your estate planning objectives. Generally, however, estate planning is considerably simpler now.

Under DOMA, same-sex married couples were subject to the same exemption and exclusion limitations as single individuals. They could not leave more than \$5.25 million to their spouse without incurring estate tax liability, nor could they give more than \$14,000 per year to their spouse without incurring gift tax liability. Now, however, same-sex married couples can transfer assets to each other as gifts or inheritance without tax consequences.

This doesn't mean that you no longer

have to plan your estate. After the second spouse dies, estate tax will be due. In addition, you may want to provide for a child or other individuals or support a favorite charitable organization. The post-DOMA environment provides you with greater flexibility—you can update a trust to give your spouse tax-free access to trust income, for example, or you can add your spouse to a property title without triggering a gift tax. But if your assets are substantial, you should still work with your advisors to create a sound estate plan.

Q. Tell me about Social Security. Do same-sex married couples stand to receive higher payments than we would have under DOMA?

A. As an earner, nothing changes. As a spouse or survivor, however, your benefits are greatly enhanced.

- Spouses can either receive the benefit to which they're entitled as a result of their work history or a benefit equaling 50% of that which their spouse is receiving, whichever is greater.
- Surviving spouses also have a choice. They can receive their own benefit or the same benefit their spouse received, whichever is greater.

To illustrate, imagine Jenny and Laura are a married couple. Jenny has had a successful career and receives a Social Security benefit of \$2,600 per month. Laura's work history only qualified her to receive a benefit of \$700 per month. In the post-DOMA environment, Laura can choose to receive a benefit of \$1,300—50% of the benefit paid to Jenny. When Jenny passes

Social Security at a Glance

(assumes the primary earner receives \$2,600 a month in benefits)

	UNDER DOMA	POST-DOMA
Jenny	\$2,600	\$2,600
Laura	0	\$1,300
Survivor Benefit to Laura	0	\$2,600

away, Laura will see her benefit raised to \$2,600.

Q. Are there other financial benefits for which same-sex married couples are now eligible?

A. Yes. Many of them are job-related. Depending on the benefits offered by your employer, you may be eligible for:

- **Better health care insurance coverage at a lower cost.** While more and more employers allow same-sex spouses to be added to their health care insurance plans, they had no choice but to offer this coverage on a taxable basis. In other words, same-sex married couples (or their employer) had to pay income tax on the employer share of spousal health care insurance cost. Thanks to the defeat of DOMA, this benefit will no longer be taxable. You should compare your current coverage with that offered by your spouse's employer and choose the plan that offers the most benefits at the lowest

cost. In addition, you may wish to amend your federal tax returns of the past three years if you paid tax on spousal coverage. You could be owed a refund.

- **Better retirement rollover choices.**

If your spouse is beneficiary of your IRA or 401(k) plan, he or she can continue to let assets grow on a tax-deferred basis until reaching retirement age, at which time he or she is required to begin taking distributions. With DOMA in effect, your spouse did not qualify for this benefit and had to begin taking taxable distributions right away. In the post-DOMA era, same-sex spouses receive the same benefits as opposite-sex spouses.

- **Better credit protection.** The ability to title assets jointly offers a degree of credit protection in the event your partner borrows excessively or fails to honor his or her debt. Joint tenants cannot borrow against the assets they own jointly without the other owner's consent. So if you own a home as joint

tenants, your partner will not be able to take out an ill-advised home equity loan without your approval. Nor will he or she be able to borrow against securities in your jointly owned brokerage account unless you agree and sign a margin agreement.

- **Family and Medical Leave Act.**

Opposite-sex couples working for large employers or public agencies are protected under federal law in the event they need time off to care for an ailing spouse. Now same-sex spouses will be afforded similar protection—up to 12 weeks of unpaid leave, plus continuation of their health care insurance.

- **Other employee benefits.** Employees covered by pensions will now be able to opt for joint-and-survivor benefits that pay their spouse in the event of their passing. In addition, employees may now add their spouses to Flexible Spending Accounts offered at their workplace.

Post-DOMA Checklist for Married Couples

Same-sex married couples now have access to benefits that were never available to them in the past. To make sure you're taking full advantage, consider the following steps:

List your spouse as beneficiary on all financial accounts

By doing so, you guarantee that your assets will be passed automatically to your spouse if you should predecease him or her. Failure to take this simple step subjects assets to probate and possible dispute among other family members.

Own your home jointly with your spouse

With DOMA in effect, you could not add your same-sex spouse to the title of your residence without essentially making a gift to him or her that might have been subject to gift tax. Now you can simply re-title your residence without tax consequences and by doing so, you will ensure that it transfers directly to your spouse upon your passing.

Don't ignore estate planning

You are no longer subject to various estate and gift tax exclusions and exemptions. And yes, your assets will pass to your spouse upon your death with no federal estate tax liability. However, many states impose hefty estate taxation that can erode your legacy considerably. Check out the laws in your state and if your assets exceed the maximum allowed before taxes apply, consult a knowledgeable estate planning attorney. Also, remember that after the second spouse passes, estates over \$5.25 million become subject to the Federal Estate Tax.

Consult with your accountant to determine whether you and your spouse should file joint tax returns

Joint filing may subject you to a marriage penalty and greater tax liability than filing separately. You should also ask your accountant about amending your returns of the past three years.



The Big Caveat

Currently, it appears that the benefits described above will be offered only to same-sex couples who are married. Couples in civil unions, registered domestic partnerships and other relationships recognized by state law do not qualify. In addition, eligibility for federal benefits does not imply eligibility for state benefits. Conceivably, you could file a joint federal tax return, for example, and have no choice but to file individual returns at the state level. Finally, same-sex married couples residing in states that don't recognize their union may not qualify for as many benefits as same-sex married couples residing in states that do. Social Security, for example, is one important benefit that may be administered differently depending on whether you live in a state that recognizes same-sex marriage.

Stay abreast of developments as they occur and remain in close contact with your attorney, accountant and Morgan Stanley Financial Advisor. The climate for same-sex married couples is changing rapidly and by the time you are reading this, greater clarity may well have emerged.

This material is based on generally available public information and is provided free of charge for general informational and educational purposes only. The information contained in this material is subject to change without notice. Morgan Stanley Smith Barney LLC undertakes no obligation to update this material. This material does not take into account your personal circumstances, and we do not represent that this information is complete or applicable to your situation.

Tax laws are complex and subject to change. Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors do

not provide tax or legal advice, are not "fiduciaries" (under ERISA, the Internal Revenue Code or otherwise) with respect to the services or activities described herein, and this material was not intended nor written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Individuals are urged to consult their tax or legal advisors before establishing a retirement plan or to understand the tax, ERISA and related consequences of any investments made under such plan and to understand the tax and legal consequences of any actions, including implementation of any estate planning strategies, or investments described herein.